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SUBJECT: REQUEST FOR ADDITIONAL REPORTING ON INTERNATIONAL FINANCIAL CRISIS

REF: A. 08 SECSTATE 134459
¶B. 08 TEGUCIGALPA 1161
¶C. 08 TEGUCIGALPA 1126
¶D. 08 TEGUCIGALPA 1114
¶E. 08 TEGUCIGALPA 1042
¶F. 08 TEGUCIGALPA 1009
¶G. 08 TEGUCIGALPA 1006
¶H. 08 TEGUCIGALPA 937
¶I. 08 TEGUCIGALPA 930

¶1. (U) Summary: Reftel requested commentary on how the international financial crisis is playing out in Honduras. Detailed reporting on the subject appears in refs B through ¶I. Following responses are keyed to questions posed in reftel. End Summary.

How the Crisis is Playing out in Honduras

¶2. (U) Ref G reported that as of early November the impact of the crisis on Honduras had been modest but that the Honduran economy would suffer significantly as the recession in the United States became more pronounced. Preliminary estimates indicate Honduran GDP growth slowed to 4 percent in 2008, compared with 6.3 percent in 2006 and 2007. The slowing U.S. economy is expected to have a negative impact on the important maquila industry. For example, several export processing ("maqila") plants announced layoffs in September-October in anticipation of slowing U.S. demand. This negative effect in the maquila sector continued in response to double-digit declines in U.S. apparel sales at key Department stores such as Macy,s and JC Penny,s. In the third and fourth quarters of 2008, layoffs reached 15,000, or nearly 10 percent of the sector,s labor force. Paradoxically, exports rose in 2008. Specifically, U.S. Commerce data for October showed total Honduran exports to the U.S. were up 11 percent in 2008, and apparel exports rose 13 percent. This marked a significant acceleration compared with the first nine months of the year, when total exports were up just 4 percent and apparel was nearly flat. We believe this may be the result of some maquila operations moving to Honduras from higher-wage countries.

¶3. (U) A key indicator to watch in the economic equation is the level of remittances that Hondurans living overseas)- mostly in the U.S. -- send to their families. These remittances are estimated at $2.5 billion per year or 25 percent of GDP, and are a primary driving force of consumer spending in the economy. Any decline in remittances caused by the U.S. recession will have negative consequences for tens of thousands of families and make a major dent on consumer demand. Again, GOH officials have taken the rosy view and are not projecting a decline in the level of remittances.

¶4. (U) Looking to 2009, the Honduran government expects a further cooling off of the economy and is projecting growth to slow to 3.4 percent. We believe this is an optimistic figure since the expected slowdown in maquila exports, as well as the decline in world prices for key exports such as coffee, bananas, palm oil and shrimp, will constrain growth prospects.

¶5. (U) Certainly, credit has tightened considerably in the last several months. A number of Honduran businesses are reporting difficulty obtaining credit since the onset of the global crisis. A number of bankers have also confirmed that the relative decline in local currency deposits and the tightening of international credit lines for Honduran banks with correspondent bank relationships with U.S. and European banks has resulted in rising interest rates for both corporate and consumer loans. The credit strain will no doubt hurt investment prospects in 2009. Nevertheless, senior Honduran officials continue to put a brave face on the situation and have insisted that there was no "financial" crisis in Honduras; only the risk of an "economic" crisis.

¶6. (U) On the positive side, Honduras, balance of payments will be strengthened by the sharp drop in the price of key imports, particularly oil and gas. Also, the global collapse of commodity prices will likely mean lower inflation, possibly to single digits in 2009. Inflation reached 11% in
¶2008.

Policy Responses

¶7. (U) Thus far, President Zelaya and his economic team have failed to forcefully confront the emerging crisis and bring the business community, labor and civil society to coalesce around a cogent set of macroeconomic policies. On the monetary side, the Central Bank has moved to cut the reserve requirement in an effort to stimulate credit. The Central Bank,s monetary easing is estimated at 11 billion lempiras. The GOH is also preparing a major Keynesian public investment program aimed at generating jobs and kick-starting economic activity.

¶8. (U) On the international side, President Zelaya, in his capacity as rotating head of the Central American Integration System (SICA), convened an emergency summit on the financial crisis in October (ref H). That meeting issued an appeal to the Central American Bank for Economic Integration (CABEI/BCIE) to provide USD 200 million lines of credit to each SICA-member central bank, at least part of which we understand was disbursed, and an additional USD 200 million to each country's commercial banks.

¶9. (U) Unfortunately, the GOH has been unwilling to commit to serious negotiations with the IMF to get their Stand By Arrangement back on track. The main policy difference has been the unwillingness of the GOH to agree to devalue or "introduce more flexibility" to the exchange rate. A number of prominent bankers and even manufacturers who have major dollar-denominated obligations are strongly backing the GOH,s position.

Internal Political Dynamics

¶10. (SBU) President Zelaya is entering the last year of his four-year term. There is no re-election in Honduras. Primaries for candidates to succeed him were held November
¶30. Zelaya has adopted an increasingly populist/leftist approach to governing over the past year, including affiliating with the Venezuelan-led Bolivarian Alternative for the Americas (ALBA) in August 2008. It is apparent that he wants his legacy to be one of having fought for the poor (poverty did decline 2005-07 according to household surveys, although some of that progress appears to have been erased 2007-08 by increases in food and fuel costs), opposed the

"oligarchs" and resisted the anti-poor prescriptions of neoliberals" and the international financial community. This will color his approach to the global economic crisis as it develops during 2009.

¶11. (SBU) On Christmas Eve, Zelaya issued a decree raising the statutory minimum wage for Honduran workers 60 percent, effective January 1 (ref B). Because the bulk of Hondurans employed in the formal sector earn at or near the minimum, and salaries of higher-paid workers in both the public and private sectors are often determined by a multiple of the minimum wage, the impact of this decree on payrolls could be enormous. Employer groups have strongly denounced the wage hike and filed injunctions against it in court. Massive layoffs and/or violent street confrontations by workers are possible as a result of this measure.

¶12. (SBU) Shortly after the wage hike, Zelaya's Energy Minister, Rixi Moncada, relented to public pressure and agreed to rescind part of the electricity rate increases (justified on the basis of higher fuel oil prices, which had since come down) imposed during 2008. Before the rate increases, the National Electric Company was estimated to be running operating losses of as much as 3 percent of GDP. The rate rebates, on closer inspection, turned out to be less than initially implied, opening Moncada and the GOH to further criticism. Zelaya's Trade and Industry Minister, Fredis Cerrato, has made repeated threats to impose/enforce price controls on various products. His ability to do so is limited, but his rhetoric has dampened business sentiment.

¶13. (SBU) On January 9, Zelaya replaced Gustavo Alfaro, head of the National Banks and Insurance Commission, with his Legal Adviser and political loyalist, former Foreign Minister Milton Jimenez. According to press reports, Alfaro was forced out because Zelaya was angry that funds made available to the banks as a result of the BCH lowering reserve requirements had been deposited overseas rather than invested in Honduras.

Impact on Relations with Third Countries

¶14. (SBU) The crisis initially gave fuel to internal arguments in favor of pursuing closer economic and diplomatic relations with Venezuela. For example, BCH President Araque appeared confident that the easing of balance of payments pressures and sufficient external financing from Venezuela would allow Honduras to avoid an IMF-recommended devaluation. The GOH subsequently signed onto resolutions calling for the establishment of a monetary union among the ALBA countries. However, the appeal of Venezuelan-led financial schemes has greatly diminished with the decline in the price of oil. Most Venezuelan assistance schemes -- through Petrocaribe, Petroalimentos and ALBA -- are linked directly to Venezuelan oil sales, and others depend on the ability of the GOV to fund them from oil revenues. The GOH is now projecting it will receive USD 68 million through Petrocaribe this year, down from USD 200 million projected before. No funds are flowing through Petroalimentos. The USD 100 million in bonds Venezuela committed last August to purchase from the GOH has not aterialized, and neither have the 100 Iranian tractors it committed to provide. To date, the tangible benefits to Honduras from joining ALBA appear to be limited to a USD 30 million loan to the Honduran agricultural development Bank (Banadesa) and some energy-saving light bulbs from Cuba (actually made in China and Vietnam).
LLORENS